

1 KEVIN V. RYAN (CSBN 118321)
2 United States Attorney

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8 UNITED STATES DISTRICT COURT
9 NORTHERN DISTRICT OF CALIFORNIA
10 SAN FRANCISCO DIVISION
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12 UNITED STATES OF AMERICA,)	No.
)	
13 Plaintiff,)	VIOLATIONS: 18 U.S.C. § 371 –
)	Conspiracy; 18 U.S.C. § 1517 –
14 v.)	Obstructing the Examination of a Financial
)	Institution; 18 U.S.C. § 1519 –
15 THOMAS C. TRAUGER,)	Falsification Of Records In Federal
)	Investigation; 18 U.S.C. § 2 – Aiding and
16)	Abetting and Willfully Causing Offense to
)	be Committed
17 Defendant.)	
<hr/>		SAN FRANCISCO VENUE

18
19 INDICTMENT

20 The Grand Jury charges:

21 I. BACKGROUND

22 At all times relevant to this Indictment:

23 A. Relevant Entities

24 1. The Office of the Comptroller of the Currency (the “OCC”) was an independent
25 agency of the United States which chartered, regulated, and supervised all national banks and
26 maintained a nationwide staff of examiners which conducted on-site reviews of national banks
27 and provided supervision of bank operations.

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INDICTMENT

1 2. The United States Securities and Exchange Commission (the “SEC”) was an
2 independent agency of the United States responsible for the administration and enforcement of
3 the federal securities laws and regulations. The SEC’s Division of Enforcement investigated
4 possible violations of the federal securities laws and regulations and brought administrative and
5 civil actions to enforce those laws and regulations.

6 3. NextCard, Inc. (“NextCard” or the “Company”) was a publicly-traded Delaware
7 corporation with headquarters in San Francisco, California. After NextCard completed its initial
8 public offering in 1999, the company’s stock was listed on the NASDAQ National Market.
9 NextCard’s fiscal year ended on December 31.

10 4. NextBank, N.A. (“NextBank”) was a wholly owned subsidiary of NextCard.
11 NextCard issued credit cards online through its banking subsidiary, NextBank. NextBank was an
12 insured depository institution and a member bank of the Federal Reserve system subject to
13 regulation by the OCC.

14 5. Ernst and Young, LLP (“E&Y”), was an international accounting firm headquartered
15 in New York, New York, with offices throughout the world, including San Francisco. E&Y was
16 engaged as NextCard’s independent auditor and performed annual audits and quarterly reviews
17 of NextCard’s financial statements.

18 B. The Defendant

19 6. The defendant THOMAS C. TRAUGER was employed by E&Y and acted as the
20 primary E&Y audit partner assigned to the NextCard engagement. TRAUGER was a certified
21 public accountant licensed in the State of California at all times relevant to this Indictment.

22 C. E&Y’s Policies Regarding Document Retention and AWS Files

23 7. At all times relevant to this Indictment, E&Y maintained a so-called “document
24 retention policy” governing the retention and destruction of documents (including hard and
25 electronic copies of documents) created by its employees in the course of E&Y’s various
26 business activities. In general, the policy required that all working papers for E&Y audits, in
27 hard copy or electronic form, be maintained for six years. The document retention policy also
28 stated that in the event of pending government investigations or threatened litigation, E&Y

1 personnel should consider whether working papers should be maintained beyond six years.

2 8. At all times relevant to this Indictment, E&Y working papers included both hard
3 copies and electronic copies of documents. Some working papers were maintained only in
4 electronic form. E&Y maintained electronic copies of audit working papers in a proprietary
5 database developed for E&Y known as the Automated Workpaper System (“AWS”). At all
6 times relevant to this Indictment, E&Y personnel generally referred to electronically stored
7 working papers as “AWS files.”

8 9. At all times relevant to this Indictment, E&Y maintained a policy governing the so-
9 called “archiving” of AWS files. In general, the policy required that AWS files were to be
10 archived at the end of an audit engagement after procedures and documentation for the audit
11 were complete. The partner in charge of the audit was to authorize the final archive procedures.
12 The archive process was to be completed within approximately one month of end of the audit
13 engagement. The policy provided further that, after the final archive was complete, the working
14 paper copy of the archive should be restored only when creating the next year’s audit working
15 papers, when creating a copy of the archive for use by a third party, or when using the prior
16 year’s working papers in a subsequent audit. The policy further provided that in the event that
17 any work was necessary to complete the documentation of E&Y’s procedures for an original
18 audit year after AWS files had been archived, the work was to be done in hard copy, dated
19 contemporaneously, and filed in separate sections of the working paper binder for that audit.

20 D. The OCC’s Examination of NextBank in Late 2001

21 10. The OCC began performing regular examinations of NextBank after NextBank
22 obtained its charter as a national bank in or about December 1999. In or about August 2001, the
23 OCC began an examination of NextBank that continued throughout the remainder of 2001.

24 11. In or about October 2001, TRAUGER knew that the OCC was examining NextBank,
25 and TRAUGER assisted NextCard in addressing concerns raised by the OCC during the course
26 of its examination.

27 E. NextCard’s Press Release Dated October 31, 2001

28 12. On or about October 31, 2001, NextCard issued a press release containing the

1 Company's results for its third fiscal quarter, ended September 30, 2001 (the "October 31
2 release"). In the October 31 release, NextCard announced, among other things, that NextBank
3 was significantly undercapitalized pursuant to federal banking regulations. The Company also
4 announced that it had withdrawn its prior earnings guidance for all future reporting periods and
5 had hired an investment banking firm to seek opportunities for the sale of the company in light of
6 NextBank's inability to meet regulatory capital requirements. NextCard also announced several
7 significant accounting and operational changes "as a result of discussions" with the OCC and the
8 Federal Deposit Insurance Corporation ("FDIC"). Among other things, NextCard announced that
9 its banking subsidiary, NextBank, would increase reserves, including its allowance for loan
10 losses, and tighten its lending requirements. NextBank also announced that it would reclassify
11 certain loan losses totaling \$12 million as credit losses that had previously been classified as
12 fraud losses, including losses on certain loans sold through the bank's securitization activities.

13 13. The October 31 release also stated that NextBank was now considered "significantly
14 undercapitalized" under applicable federal banking regulations and would be subject to "prompt
15 corrective action" pursuant to federal banking laws, requiring NextBank to submit a capital
16 restoration plan acceptable to the OCC and to be subject to heightened regulatory scrutiny.

17 14. In trading immediately following the October 31 release, shares of NextCard
18 common stock lost approximately 80% of their value.

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1 COUNT ONE: 18 U.S.C. § 371 (Conspiracy to Obstruct Examination of Financial Institution)

2 15. Paragraphs 1 through 14 are realleged as if fully set forth here.

3 16. Beginning on a date unknown, but no later than in or about November 2001, and
4 continuing until a date unknown, but no earlier than in or about April 2002, in the Northern
5 District of California and elsewhere, the defendant

6 THOMAS C. TRAUGER

7 and others, did knowingly and willfully conspire to corruptly obstruct the examination of a
8 financial institution, specifically the examination of NextBank, N.A. by the Office of the
9 Comptroller of the Currency, in violation of Title 18, United States Code, Section 1517.

10 II. THE MANNER AND MEANS OF THE CONSPIRACY

11 _____ 17. It was part of the conspiracy that TRAUGER and others would and did destroy, alter,
12 and falsify for its fiscal year ended December 31, 2000, and E&Y's review of NextCard's
13 financial statements for its quarterly reporting periods ended March 31, 2001, and June 30, 2001.

14 18. It was further part of the conspiracy that TRAUGER would and did cause and direct
15 others to collect and produce altered working papers to the OCC, pursuant to an OCC subpoena
16 dated March 1, 2002.

17 III. OVERT ACTS

18 19. In furtherance of the agreement and to effect its objects, the defendant committed,
19 among others, the following overt acts in the Northern District of California:

20 a. In or about November 2001, TRAUGER and Oliver Flanagan, the senior
21 manager on E&Y's NextCard engagement team, met at E&Y's San Francisco offices on a
22 Saturday;

23 b. In or about November 2001, TRAUGER and Flanagan altered working papers,
24 including AWS files, relating to E&Y's 2000 audit of NextCard's financial statements for its
25 fiscal year ended December 31, 2000;

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27 c. In or about November 2001, TRAUGER, Flanagan, and an audit manager on
28 E&Y's NextCard engagement team (the "Audit Manager") met at E&Y's San Francisco offices

1 after business hours;

2 d. In or about November 2001, TRAUGER, Flanagan, and the Audit Manager
3 altered working papers, including AWS files, related to E&Y's reviews of NextCard's financial
4 statements for the fiscal quarters ended March 31, 2001, and June 30, 2001, and working papers,
5 including AWS files, related to E&Y's 2000 audit of NextCard's financial statements for its
6 fiscal year ended December 31, 2000;

7 e. In or about November 2001, TRAUGER directed Flanagan to meet with a
8 former member of NextCard's engagement team in order to alter a NextCard working paper;

9 f. In or about March 2002, TRAUGER told Flanagan to destroy e-mail and other
10 documents on his E&Y computer that related to the alteration and destruction of NextCard
11 working papers;

12 g. In or about March 2002, TRAUGER told Flanagan to destroy a computer disk
13 that appeared to contain information related to NextCard; and

14 h. On or about April 5, 2002, TRAUGER caused E&Y to produce documents to
15 the OCC in response to an OCC subpoena that included documents that had been altered and
16 falsified by TRAUGER and at TRAUGER's direction.

17 All in violation of Title 18, United States Code, Section 371.

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COUNT TWO: 18 U.S.C. §§ 1517 and 2 (Obstructing the Examination of a Financial Institution)

20. Paragraphs 1 through 14 and paragraphs 17 through 19 are realleged as if fully set forth here.

21. In or about April 2002, in the Northern District of California and elsewhere, the defendant

THOMAS C. TRAUGER

did corruptly obstruct the examination of a financial institution, namely NextBank, N.A., a chartered national bank and wholly owned subsidiary of NextCard, Inc., by an agency of the United States with jurisdiction to conduct an examination of such financial institution, namely the Office of the Comptroller of the Currency.

22. Specifically, TRAUGER willfully caused others to produce documents related to the annual audits and quarterly reviews of the financial statements of NextCard, Inc. by Ernst and Young to the Office of the Comptroller of the Currency, pursuant to a subpoena dated March 1, 2002, knowing that some of the documents required to be produced by the subpoena had been destroyed, altered, and falsified.

All in violation of Title 18, United States Code, Section 1517, and Title 18, United States Code, Section 2.

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INDICTMENT

1 COUNT THREE: 18 U.S.C. § 1519 (Falsification Of Records In Federal Investigation)

2 23. Paragraphs 1 through 14 and paragraphs 17 through 19 are realleged as if fully set
3 forth here.

4 24. On or about April 30, 2003, the Northern District of California and elsewhere, the
5 defendant

6 THOMAS C. TRAUGER

7 did knowingly conceal and cover up a false entry in a record, document, and tangible object,
8 namely certain records and documents related to the annual audits and quarterly reviews of the
9 financial statements of NextCard, Inc. by Ernst and Young LLP, with the intent to impede,
10 obstruct, and influence the investigation and proper administration of a matter within the
11 jurisdiction of any department and agency of the United States, namely the Securities and
12 Exchange Commission.

13 25. Specifically, on or about April 30, 2003, during sworn testimony before officers of
14 the Securities and Exchange Commission, TRAUGER concealed and covered up his alteration
15 and destruction of working papers related to NextCard when he was asked to describe his actions
16 in response to a subpoena from the Office of the Comptroller of the Currency, dated March 1,
17 2002.

18 All in violation of Title 18, United States Code, Section 1519.

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20 DATED:

A TRUE BILL.

21
22 FOREPERSON

23 KEVIN V. RYAN
24 United States Attorney

25 ROSS W. NADEL
26 Chief, Criminal Division

27 (Approved as to form: _____)
28 AUSA William H. Kimball
AUSA Anne Christine Massullo

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